RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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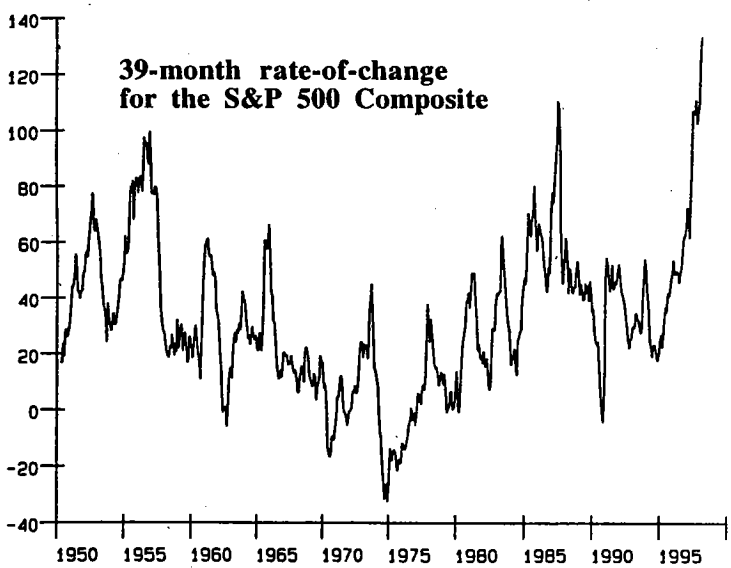
Apr. 8, 1998 **LETTER 1249**

THE MARKET: Is the stock market's forecast of the future right or wrong? Market veterans and old-timers who've been studying the market for decades are wondering, based on the market's powerful upside action, whether we're moving into one of the great economic expansion periods in American history -- or whether we're in the process of building a giant financial bubble as Japan did during the 1980s.

This chart (courtesy of *ISI*) shows the 39-month rate-of-change in the S&P 500. As of early-March the 39-month rate-of-change was at a record-breaking 132%. Obviously, this fantastic rate-of-change spike will have to top out somewhere ahead, and the question then becomes -- how does the market act after the spike?

One of two things can occur: the market can continue to rise but at a **lower** rate-of-change, in which case the spike would reverse and slowly decline. Or the market could come down with a vengeance as it did following the 1973-74 spike, in which case the spike would reverse and then crash.

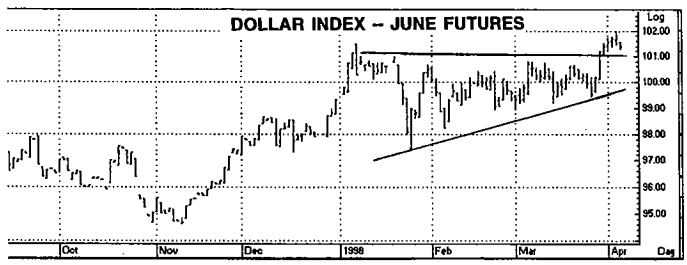
As this is written, we should realize that the S&P 500 has been rising at one of the **fastest rates in half a century**. It makes you wonder what's fated for Wall Street and the economy in the months ahead.



In the meantime, the dollar is close to breaking out of a large ascending triangle, this while the Japanese yen is sinking. With Asia in recession and cutting back drastically on its imports while at the same time exporting strongly, and with the strong dollar rendering US exports even more expensive, the US trade balance is fated to go negative in a major way. **Note:** There are now 133 yen per the dollar, and the yen continues to weaken. US car dealers have said that they can't compete with Japan if the yen drops to 140 per dollar. We may soon find out whether the dealers are correct or not.

Each bull market has its own peculiar reasons and rationales for being, and this one is no exception. But the question: how can this bull market ignore all the classic, time-honored measurements of valuation? Consider the following: the yield on the Dow is now an

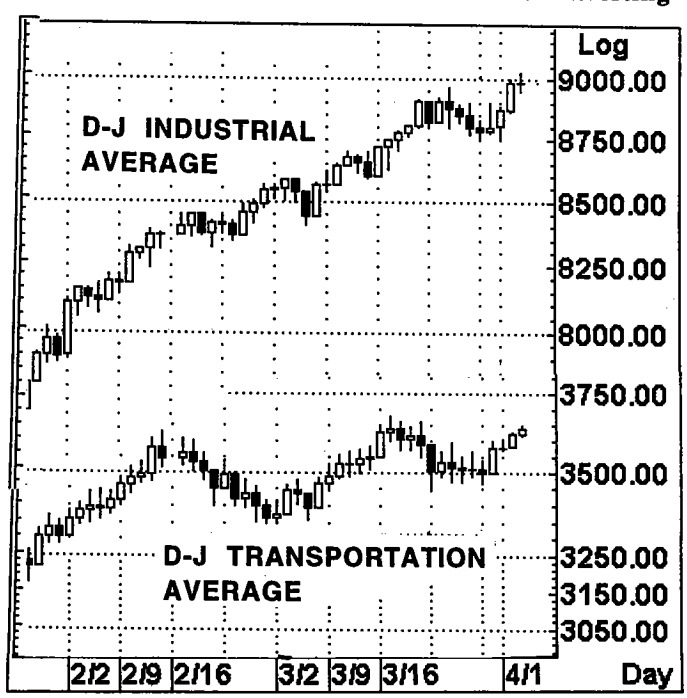
Mar. 27 DJIA 8796.08; PTI 5314; A-D Ratio +12.57
Apr. 3 DJIA 8983.41; PTI 5334; A-D Ratio +13.00
Dow Yield: 1.56%; Dow Price/Earnings: 23.2
Dow 144-day MA: 8140; Dow 34-day MA: 8674
Dow Times Book Value: 6.36; PTI 89-day MA: 5227
Percentage of Undervalued Blue-chips: 2%
Gold 34-day MA: 301.10

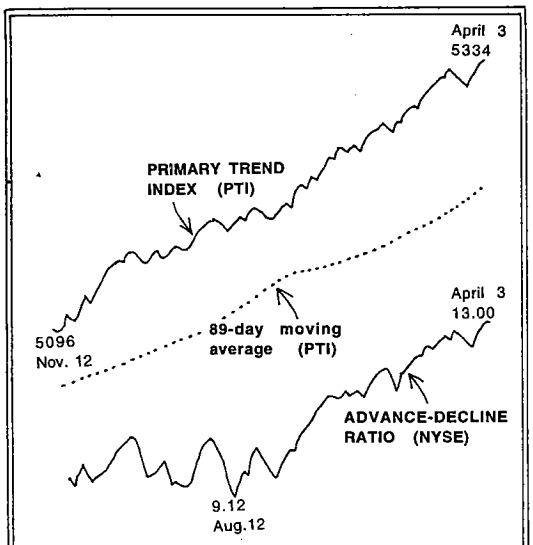


incredibly low 1.59% and the yield on the S&P 500 is even lower at 1.45%. Consider that the price/earnings ratio for the Dow is now 22.7 times record earnings, while the P/E ratio for the S&P is 27.5 times record earnings (historically, the market's average P/E for record earnings has been 12). Consider that the Dow now sells at 6.3 times its book value, while the S&P sells at 6.04 times book (bargain time is 1.0 times the book value).

In light of the above, what have today's leading analysts been thinking? The answer is that they've been thinking differently. Today's widely-accepted method of valuation is to **estimate future earnings on the Dow or the S&P and then to adjust those earnings to prevailing interest rates.** The lower the prevailing interest rates, the more richly the market capitalizes future earnings. Dividends, price/earnings, book values -- forget 'em, it's future earnings estimates adjusted for current interest rates that are moving the market today.

There's a second phenomenon peculiar to this market, and I've touched on this before. It's the **"automatic investing"**





New highs registered in both of these indicators. Many people are anxious to turn bearish on this market, but I urge them to hold their bearishness in abeyance until the PTI turns down on a trend basis. Sure hasn't happened yet.

syndrome. Every day, every week, multi-millions of dollars flow into Wall Street from savings, from salaries, from 401(k)s and from pension plans. And as I said, the process is automatic. Up to now there have been a lot of buyers and very few sellers. It's been a one-way street. Consequently, the market has continued to rise.

Question: What could reverse this process? Simple answer: More sellers than buyers. Next question: What would cause investors to sell? Only three items will generate important, persistent selling: **(1)** rising interest rates; **(2)** declining corporate earnings; **(3)** a totally unexpected event such as a war or an unforeseen calamity.

Profits: The March 27 *WSJ* announced that "corporate profits posted their steepest decline in nearly four years in the final quarter of 1997, this despite the fact that the economy continued to grow at a healthy pace," **Question:** In the face of that kind of profit slump, why is the market still acting bullishly?

Answer: The fourth quarter 1997 is history. The stock market isn't interested in yesterday, it's only interested in tomorrow. So what about "tomorrow's earnings?" Here's how leading analysts are predicting earnings for the S&P (seasonally adjusted at annual rate): earnings up only **1.4%** for the first quarter '98, up **7%** for the second quarter, up **11.9%** for the third quarter and up **17.4%** for the fourth quarter (estimates courtesy of Ed Hyman of *ISI*).

Clearly, this market is **looking well past** the current first quarter of '98 and towards the third and fourth quarters and even into '99. Next, the obvious **question** -- how accurate are third and fourth quarter forecasts? And how much impact, if any, will the Asian recession have on the US' third and fourth quarter corporate profits? **Answer:** So far, it's obvious that the stock market is very optimistic regarding the rest of '98 and has not been arguing with the analysts' estimates (this regardless of Asia). Of course, if the forecasts turn out to be wrong, the stock market would have a lot of, mmm, "adjusting" to do.

Inflation or not? Up to this year the nation's surging money supply has largely flowed into the stock market. But the good times have been spreading. In recent months I've written about the movement of "big money" into luxury goods, jewelry, watches, art, auction items, expensive cars. Now big money is moving into real estate and housing. Home prices are surging, rentals are heading up, condos and co-op prices are racheting higher.

So you have to wonder whether the inflation rate can continue to remain low. The ace-in-the-hole for the stock market and the economy has been the collapsing economies of Asia plus the flood of low-priced Asian goods that are landing at our shores. The Asian collapse has been the one major bastion against US inflation.

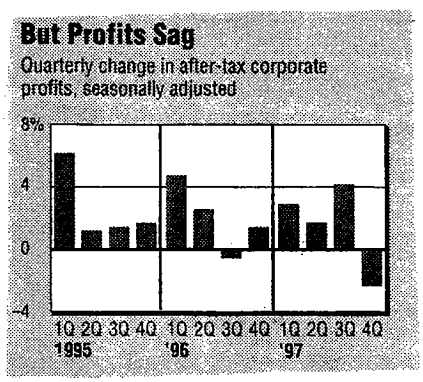
The question I ask myself is whether the forces of inflation can be held back. Can the Asian recession (which comprises one-third of the world's economies) neutralize the potential forces (surging money supply) of inflation in the US? No one has the answer yet. But as far as the stock market is concerned, the Asian situation has been a non-event. Furthermore, the market is saying that inflation is not a problem.

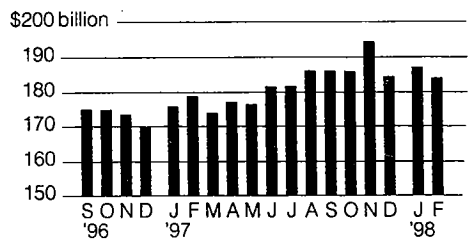
Conclusion: It's still a bull market. Let's keep our eye on the D-J Transportation Average, which recorded its high of **3636.81** a month ago on March 1. The PTI is at its high, as are the Dow and the S&P.

Probabilities: Experienced, veteran investors know that they are always dealing with probabilities. They know that probabilities don't always work (for instance, look at the probability of the Dow rising 150% during 1993-96), but it's never wise to totally ignore probabilities.

Here are some **possibilities to consider now:** in the 77 years since 1921, the S&P declined 25 times or roughly one out of every three years. But any time when the S&P started the year at 20 or more times the previous year's earnings, it went down 62% of the time. **Note:** the S&P started the year 1998 at 24.5 times 1997's earnings. **Second note:** historically the market has been down one out of every three years -- but the last time this market produced a down year was eight years ago in 1990.

Fundamentals: Here are two charts worth studying (courtesy the *WSJ* and *NY Times*). I present these because so many analysts are now in the game of **predicting future market earnings**; of course all they are doing is extrapolating prevailing trends. Predicting the fourth quarter's or next year's earnings is a very chancy procedure.





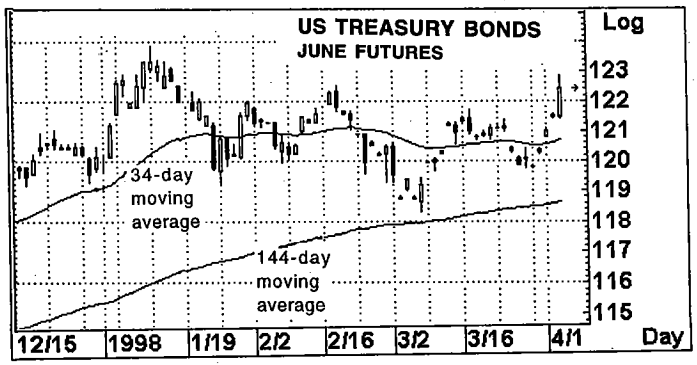
Manufacturers' total new orders for durable goods, seasonally adjusted.

Just as dangerous, of course, is predicting **where the Dow will be** a year or two years from now. But that doesn't stop many analysts, who are offering predictions of everything from "Dow 10,000 in 1999" to "Dow 20,000 in 2010." It's all hype and ego. All we really know is that the market moves in trends, and that a trend will continue until it ends -- and then reverses.

Technical analysts write a great deal about how certain phenomena "almost always" occur prior to market tops -- such as the advance-decline line "usually" topping out 4-6 months before the general market. Or the bellwether Utility Average "almost always" topping out months before the rest of the market. All

generally true, but remember, this is a very unusual market and it has done a lot of very unorthodox things. My PTI couldn't care less about usual patterns or usual cycles or usual occurrences. The PTI cares only about what the market is **actually doing NOW.** Which, of course, is the bottom line. So watch the PTI. It's a cold, emotionless indicator, and it doesn't give a darn about past history or what you think or what the experts believe the market "should" be doing.

BONDS: The key to stock market action here is probably the action of the bonds. The chart (June Treasury bond futures) shows that on the corrective action since the January 12 high, the 34-day moving average (MA) never even came near the 144-day MA, an indication of strength. Then on April 1 the bonds surged back **above** their 34-day MA, triggering a "buy signal" by my method. Note the declining trendline which has been in force since the January 12 high. On April 2 the bonds surged above this trendline, a second bullish development. Last week's action puts the bonds in line to attack the January high at 123 28/32nds. The stock market obviously likes the bond action -- and since I own bonds, so do I.



MEASURE OF SAFETY: Be sure to read the article, "Three Little Words," in the latest (April 6) issue of *Forbes* magazine. The article discusses Warren Buffett, what he's doing, and his philosophy. The article notes, "The efficient market theory tells you that price is the same as value." In other words, the market "knows everything," and therefore price is always correct. Translation: the price of a stock is what a stock is actually worth from a value standpoint . . . "Buffett thinks markets are somewhat efficient but **not perfect**." In other words, Buffett believes that there is often a gap between price and real value.

Ben Graham, Buffett's mentor, believed that in the short run markets are voting machines, but in the long run they are weighing machines. Graham taught that on a **daily** basis, people are expressing their hopes and fears. But over a **long period** of time, the voting (emotions) will be corrected and the gap between price and value will narrow.

Then the article asks the question, "We've had a bull market for 15 years. This isn't Ben Graham's world, is it?

"Answer: Graham would say we're just experiencing a phase where there is an extraordinary amount of greed, and a mind-set of endless prosperity. What Graham wouldn't understand -- what would be totally unrecognizable to him -- is the degree to which fashionable academics think that these emotions have been purged from the market process, that the market is getting it right every day and that price and value are functionally the same."

Put all the above together and you can see why Warren Buffett (who's a Graham student) is cautious, why he's hesitant about buying stocks and why he's been buying "non-stocks," silver and zero bonds. The *Forbes* article ends with the paragraph, "Graham said the three words that are the key to investment success are **'margin of safety'.** Buffett still thinks that those are the three right words."

I've actually discussed this whole thesis before in these Letters, but I want to add a few additional thoughts. If you were to live to be 150, you could be a guaranteed millionaire simply by starting early and then safely compounding your money in government bonds. In 50, 75, 100 years you'd be a multi-millionaire. Stocks are, hopefully, a way to **beat time.** If you pick the right stocks and hold them through a big bull market, you might make your millions in five or 10 years instead of waiting patiently via the long-term compounding process.

BUT, and this is a big but; the killer, the financial murderer, is the BIG LOSS. A big loss can be inflicted by doing something stupid, by buying the wrong stocks, or by sitting through a major bear market. It's very hard to recover from a big loss. A big loss is tough on your ego, very tough on your nerves, and extremely tough on your portfolio.

As I've often explained, if you have a $100,000 portfolio of stocks and you lose $50,000, that represents a 50% loss. But to get your portfolio back to $100,000 you have to generate a profit of 100% after taxes. And that's not easy.

And that's why intelligent, experienced investors will often forego a huge potential profit in the name of safety. They know that it's great to make money, but it's a disaster to suffer a big loss. Thus those three words, "margin of safety," are crucial in Buffett's thinking. I know it's been crucial in my thinking.

Interestingly, in the same issue of *Forbes* there's an excellent four-page interview with my old friend, Marty Zweig. Toward the end of the piece the interviewer asks Marty how he compares himself with Warren Buffett. Marty's answer: "He's a moonshot ahead. I could never do what he does. He buys things and holds forever -- correctly, because he recognizes that if you sell and pay taxes, it cuts your return. My problem is, I can't sit through bear markets. Buffett says that if you can't afford to see your stocks go down 30% or 40%, you shouldn't be in it. I can't take the pain. I built my technique on what I can handle personally. This means I have to be in and out a lot. My main thing is, I want to survive. I want to be there, and when the big bear market comes, I don't want to get chewed up. It's a lot of stress. But one thing about the market -- it's never bored me. The problem is, it's driven me nuts at times. I don't eat when I'm upset. Some people do, I don't. How many nights did I order scrambled eggs for dinner because it was the only thing I could get down?"

Russell Comment: There are gamblers in the "big game" at Binions in Las Vegas who end up betting "it all." The final pots are huge, hundreds of thousands of dollars. If they win it all, great. If they lose it all, they evidently just keep going. I always found that amazing. I couldn't do it. I couldn't sit with stocks through the 1973-74 bear market. I, like Marty, don't have the stomach for it.

I've always told my subscribers that there is a huge difference between taking a big loss and missing a big profit. One is a heart-stopper, and I've already had one heart attack. The other is frustrating, but in this business if you can't take some frustration you should be doing something else, something not connected with the stock market.

The stock market is the devil's own psychologist. The market will **always attack your weakness.** If you're greedy, if you're fearful, if you're vain, if you're dishonest, if you're impatient, if you're illogical -- as sure as the sun rises the market will find your weakness and make you pay for it.

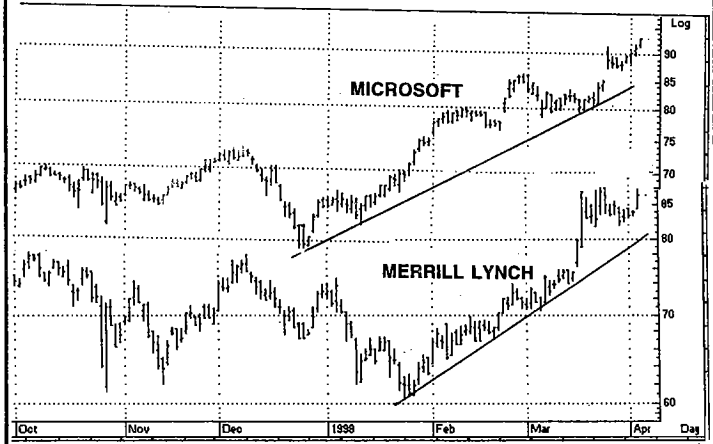
You may not be able to overcome your weakness, but you better be aware of it -- and you better do your investing accordingly, according to your own abilities.

INVESTMENT POSITION: I've said that this bull market will end in only one way -- exhaustion. Secret -- it's **not** exhausted yet. The bull remains in the box. The trend of the market is UP.

If you are single and your income is under $95,000 (married -- joint income of $150,000) and you haven't thought about a Roth IRA, I suggest you do so. In the Roth you place already-taxed

money into the IRA ($2,000 limit), and the account compounds tax free. The kicker is that when the IRA is shut down, the money is taken out free of taxes. The Roth IRA is a good way to compound money and build assets, particularly if you have a lot of time on your side (meaning if you are on the "young-ish" side when you start). Roths also allow people with adjusted gross incomes of less than $100,000 to convert a traditional IRA to a Roth, but you are required to pay taxes on your original IRA -- although taxes are assessed over a four-year period starting with this year.

Two bellwether stocks that I watch closely are Merrill Lynch and Microsoft. Merrill because Wall Street is extremely sensitive to coming trends in stocks (volume) and Microsoft because it is a huge capitalization leader and watched by everybody, and because it (like Clinton) is powerful but always in some kind of trouble. Both stocks are telling us that if there are negatives ahead, they don't see them.



Again I warn subscribers that there is often a vast difference between what various experts think the market "should" be doing, and what it's actually doing. What the market's actually doing is advancing.

The rumor, out Monday, is that Buffett has sold one-third of his silver position. Does that mean he has turned bearish on silver? I don't think so. I think Buffett has taken a nice profit on a portion of his silver play, and I'm guessing that he'll ride out the rest of his position. Smart move, Mr. Buffett, it's called hedging.

NOTES & QUOTES: Eight of the 30 Dow Industrial stocks now yield **less than 1%:** the eight are Amer. Express, Hewlett-Packard, Travelers, Coke, IBM, Wal-Mart, Disney, and McDonald's. No Dow stock yields more than 3.85%. The five highest yielding Dow Industrials are Philip Morris 3.84%, Chevron 3.04%, GM 2.97%, JP Morgan 2.83%, and Kodak 2.71%. Twenty years ago if I had predicted this paragraph I would have been considered Loony Tunes.

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Writes Ed Hyman of *ISI*, "We believe the core Pacific Rim economies are in free-falls as suggested by the -58% annual rate of decline reported last week for Thai imports . . . China's industrial production is still up 5% year-to-year, but it has declined at a -16% annual rate over the past three months . . . To a surprising extent, Japan's economy also has a free-fall look to it. We calculate their first quarter GDP to be down roughly -2% year-to-year, its weakest reading since 1974." **Russell Comment:** People don't realize how big and how important the Japanese economy is. Consider this, with a GDP of $4.5 trillion the Japanese economy is as big as the German GDP ($1.45 trillion), the French GDP ($1.17 trillion), the UK GDP ($1.14 trillion) and the Italian GDP ($1.09 trillion) **combined.**

Japanese government bond yields have dropped to their lowest level (1.5%) on record. Incredibly, that has not stopped savings minded Japanese from buying them. Seven years ago the yield on Japanese government bonds was 8%, but since then the drop has been relentless.

Against the above, interest on the US long Treasury bonds is about 5.95%. I remember during the '60s when the government came out with the "Magic Fives" (Treasury bonds yielding 5%). It was said that these bonds "would draw money from the moon." At that time a fat 5% yield seemed incredible. Today if the yield on the long bond were to drop to as low as 5%, the word would again be "incredible," but of course this time incredible would have an entirely different meaning.

* *

One result of the **Asian recession** is seen in the Asian shipping firms. Thousands of empty shipping containers are piling up at Long Beach, California and other West Coast ports because of collapsing demand for US products, intensified by the surge in newly-cheap products bound for the US. In other words, the boats come to the US loaded with goods, and they leave here empty. "Ships are filling up eastbound, but westbound is an absolute disaster," says Jay Winter, executive secretary of the Steamship Assoc. of Southern California. Says Tom Cowan, senior VP of Pacific services for Sealand Services, "I've been in this business for 26 years and I've never seen anything like it."

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Officials of Japan, with amazing bluntness, say they want the Nikkei (stock average) above 18,000 and soon (it's now in the high 15,000s). Some ruling party officials have said that to get the Nikkei above 18,000, huge sums from government-controlled postal savings, pension and insurance systems (upwards of $10 billion worth) should be poured directly into the Japanese stock market and soon. The Japanese government routinely interferes with the economy, but the blatant buying of securities by the Japanese government may be too much even for cynics to digest.

Would the **US Treasury** or the Fed ever go into the stock market to, ahem, hold it up or move it up? I've heard rumors that the Democrats want this market to look good until the next presidential election and that the Fed's Stabilization Fund has been buying S&P futures on any signs of weakness. Personally, I don't believe it, but I guess anything's possible. Actually, I believe Greenspan is worried about the careening market, and would like a market correction, something to show investors that the market is a two-way street (secretly, I believe that Greenspan is smarting from the fact that the stock market totally ignored his December '96 warning of "irrational exuberance," at which time the S&P was 50% lower than it is today).

* *

Observers continue to wonder whether **China** will devalue its currency. Ironically, China has the lowest costs in Asia, but it is being outpriced by other Asian nations which have devalued their own currencies. China has a problem of declining growth rates and rising unemployment. If China does devalue the yuan, it would send shock-waves throughout Asia and probably set off a second series of competitive devaluations. Personally, I think there is a good chance that China will devalue.

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Based on new highs across the board in European stock markets, economies in **Europe** are probably accelerating. The irony is that with economies doing well, the unemployment rate in Europe remains high. What's happening is the major European corporations have been sending their manufacturing and parts buying abroad, which means that although their sales and profits have been rising, they are not hiring Europeans. Thus, unemployment in both Germany and France remains at a very high 12% with no indication that either is coming down.

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Back in the early '60s I first became interested in **foreign stock markets**. But problem: you couldn't find out what their stock averages were doing, and it was almost impossible to get quotes on their stocks. Actually, a few Swiss banks did compute stock averages for various nations, but the banks wouldn't release any information. Times change; now I hear quotes on Japan, Hong Kong, Britain and Australia all night long (radio station KNX out of LA). In fact, I think today the public is over-inundated with market news plus a virtual torrent of assorted financial garbage.

Just listen to the "hysteria" on CNBC prior to and at the time of the NYSE opening each morning. There's so much excitement it sounds like we're being attacked by Martians -- and I have to tell myself, "Hey, it's only the opening on the Big Board, relax, take a deep breath."

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Speaking of **change**, I remember a few years ago when the "baby Berkshires" (mini-shares in Berkshire Hathaway) came out, Warren Buffett thought the stock market was high, and he stated that he himself wouldn't buy the mini-Berkshires at the current price. But now, thousands of Dow points higher, Buffett says, "There's no reason to think that stocks are generally overvalued" as long as interest rates stay this low and returns on equity this high.

What's changed Buffett's mind? Here's what I think has happened. At first Buffett was worried by the "high-priced" market and he said so. But as his own stocks climbed, he obviously had to feel good, and he looked for a rationale to justify the massive rise in Berkshire's net value. Buffett finally gave some credence to the earnings adjusted to interest rates thesis and decided that there was no sense in fighting the tide, particularly since it was making him progressively richer. **Russell Comment:** A big bull market, sooner or later, turns everyone into believers (note the long article on the op-ed page of the March 30 *WSJ* on the thesis that the stock market is not overpriced).

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The latest *Fortune* magazine (April 13) includes a rather shocking article on the IRS, the caption, "Unbelievable! The mess at the IRS is worse than you think. A year 2000 problem? Try 1950. The IRS computer code was old when the Beatles were young. The taxman has more trouble than Washington wants you to know." The article begins, "However badly run you think the IRS is, it's worse. The agency that processed 209 million of the most complicated forms known to humankind using computer systems mostly designed in the 1950s, built in the 1960s, and jury-rigged since. Some still bear the frontier-days emblem of Sperry Univac. A large chunk of the IRS' 62 million lines of computer code is so ancient that young technicians can't read it; the agency has to pay incentives to retain programmers who can. Charles Rossotti, the commissioner, told *Fortune* that upgrading his vacuum tube-era technology 'will be like rebuilding Manhattan while we're still living in it' . . . The $7 billion agency is Washington's biggest basket case. It has attempted the same gargantuan task of modernizing its computers for 25 years and failed every time . . . The system is a tangle of 80 mainframes, 1,335 minicomputers, and 130,000 desktop boxes that are largely unable to communicate with each other. 'We go all over the Third World countries, and we've never seen a system that's this Rube Goldberg and this old,' a computer expert told former IRS commissioner Lawrence Gibbs." **Russell Comment:** Re-read the letter from a subscriber included in the last issue of DTL. The writer thinks the whole tax system will break down when Y2K hits in the year 2000.

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The price and demand for **housing** continues to surge on both coasts (the Seattle, Boston and LA markets are white hot). A few weeks ago a new "village" of 21 homes opened in Newport Beach, California. To date, over 5,000 people have trooped through these houses and the company already has 200 applications on hand. In Seattle, six bidders competed for a cottage-style house, which sold in two days for $40,000 over list. A survey in Boston showed that 75% of the houses in the over-$800,000 class are selling at above-list price. Here in La Jolla, brokers tell me that the inventory in houses is the lowest in years, and homes coming on the market sell within a day or two. The word is, "If you see it and like it, you better buy it or it will be gone by tomorrow."

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Signs of the Times: NBC just signed a deal to keep the hit comedy, "Mad About You," for another season. The two principal actors demanded $1 million a piece for each show (there'll be 22 shows next year). The two stars got what they wanted . . . The Academy Awards show asked $1 million for every half minute of advertising, thereby matching the Super Bowl price. The Academy got what they asked for . . . Cleveland will get an expansion football team in 1999. The price is expected to set a record for a sports franchise, a mind-boggling $350 to $500 million. In 1961 Art Modell paid $3.9 million for the Cleveland team . . . Rolls Royce was just bought by BMW for a fat $572 million; Vickers bought Rolls in 1980 for $50 million.

* *

The so-called war on drugs drags on and on. The numbers are mind-blowing. America now has 1.5 million men and women in prison. Roughly 80% of the crimes are alcohol or drug related. Americans spend upwards of $150 billion a year smoking, consuming or shooting up drugs, and the nation spends $34 billion a year either fighting drugs or housing drug offenders. In 1996 the US jailed 545,000, mostly youngsters, many serving long sentences for holding small amounts of marijuana. The feeling among many experts and law enforcement officers is that the war on drugs has been lost. Nothing seems to stop the inflow of drugs to Americans who are voracious drug-users. Many feel that non-violent drug addiction is a medical problem and that sending offenders to prison is the wrong solution. In the meantime, the "lost war" goes on, and on, and on. And no politician has the courage to even question it.

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More on Y2K, the dreaded Millennium bug. In the past few weeks, Citicorp reported that its costs for fixing its computers may hit $600 million, Chase Manhattan says their costs will be $250 million, JP Morgan -- $250 million, Bankers Trust New York -- $180 million, BankAmerica -- about $380 million, GM -- as high as $500 million. **Russell Comment:** Pretty soon you're talking about real money. Note: The US government says that so far they've only "fixed" 35% of their most vital federal mainframes and that they won't have time before Dec. 31, 1999 to prevent all 5,100 remaining machines from not knowing the year 1900 from 2000.

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On March 26 a strange, very touching but festive parade took place through the streets of La Jolla. The parade was in honor of a great man, Dr. Benjamin Spock, America's "Baby Doctor." Dr. Spock died here in La Jolla on March 25 at the age of 94. He's a man who changed the lives of thousands of people (starting when they were one day old).

I was born in 1924. At that time leading baby authorities suggested that mothers should let their babies "cry it out;" in other words, let 'em scream for hours until they damn well learn that screaming will get them nowhere ("above all, don't spoil 'em"). Mothers were told to feed their babies "by the clock," rather than on demand. If the tikes were hungry and cried for food, let them wait until the time was right -- and then, feed them baby food and forget about breasts ("breast feeding is unsanitary"). Mothers were warned not to pick up or caress their boy babies too much, the penalty being that the little fellows would grow up to be homosexuals. That was the kind of treatment that I lived through as an infant. For many babies of the 1920s and '30s, it was survival time. Dr. Spock changed most of that, and intelligent, modern mothers now ask for "rooming-in" at hospitals, they breast feed their babies, and they pick them up when they cry. Times have changed to a very large extent, and much of it due to the great doctor Spock.

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Almost every rogue nation and potential adversary is developing or already has missile capabilities. So what has happened to the US' anti-missile defense system? So far, $50 billion has been spent, and there's still nothing much to show for it. Says John Pike of the Federation of American Scientists, "They have thrown billions of dollars at these programs and they've not hit anything. It's politics and pork and has little to do with security." Lt. Col. Rick Lehner of the Pentagon's Ballistic Missile Defense Org. says the agency agrees with the pessimistic reports. His agency is "evaluating" new reports, including one that calls for a total overhaul of the national missile defense effort.

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Mighty **Goldman Sachs** is thinking of cashing in, better known as going public. Estimates are that Goldman could be worth around $22 billion. If so, the 190 general partners could share in a bonanza of about $16 billion to the various partners, based on each one's ownership percentage. That could mean $160 million for top senior partners while junior partners might get a mere $40 million.

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The race for governor of California is in full swing already. Three millionaires are vying for the Democratic candidate and the three are spending at the rate of $2.5 million a week for TV spots. It's not going to be easy. Says Sal Russo, who is planning State Treasurer Matt Fong's campaign (Fong is running for Senate), "This year, in the high-visibility races for governor and senator, I think they're barking up the wrong tree, because never in modern times have we had an electorate that has been this contented and satisfied. There's been a total aversion to someone who says, 'I'm going to go in there and shake up things and create risk.' And that's the message, whether they like it or not, that an outsider who's rich is telling people." **Russell Comment:** I agree, and so does Clinton. That's why he's the total status quo president. And that's why Clinton is talking up a lot of minor programs that are calculated to not stir up anything. As far as the Republicans are concerned, they're asleep at the switch. They're shivering and shriveling, deathly afraid that anything they propose will be beat up and spit out by Clinton.

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Here's a fascinating concept -- WorldSpace Inc. is moving to send up satellites which will broadcast radio programs (75 programs of digital-quality music and news) to Africa, Asia, South America and the undeveloped areas of the world. WorldSpace has already raised $950 million. Four large Japanese manufacturers have agreed to make millions of the needed radios. In September the company will send up AfriStar, the first of three satellites. The next two, AsiaStar and Ameristar, will go up next year. It's another link in the trend to connect people in every part of the globe.

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VALUES: Some of the following is repetitive, but the concept is absolutely **critical** and I want my subscribers to fully understand it. Does Greenspan think the market is overpriced? Well, let's see. Greenspan values the market as follows: he takes the predicted **earnings/yield** on the S&P 500 for the coming 12 months and then compares the earnings/yields with the yield on the 10-year Treasury note. According to S&P's *The Outlook,* the estimated earnings on the S&P for 1998 are 48.21. Dividing this by the price of the S&P gives us **4.32%.** This is the S&P's earnings/yield. Now compare this with the yield on the 10-year note which is **5.56%.** On this basis, the market is overpriced. This is one reason why Greenspan is very reluctant to raise rates (which would put pressure on the stock market).

But the 500 stocks in the S&P do not have the quality of the 30 D-J Industrials. So let's try it with the Dow. *The Outlook* estimates the Dow earnings for 1998 at 484.13. Dividing this by the price of the Dow gives us an earnings/yield of **5.40%**, quite close to the **5.56%** yield on the 10-year note.

Checking these figures, it's clear that on the basis of using the Dow and the 10-year note, the market is close to being fairly priced. The variables are (1) whether interest rates now rise or decline, and (2) whether earnings can reach the predicted estimates -- or whether they will surprise on the upside (or on the downside).

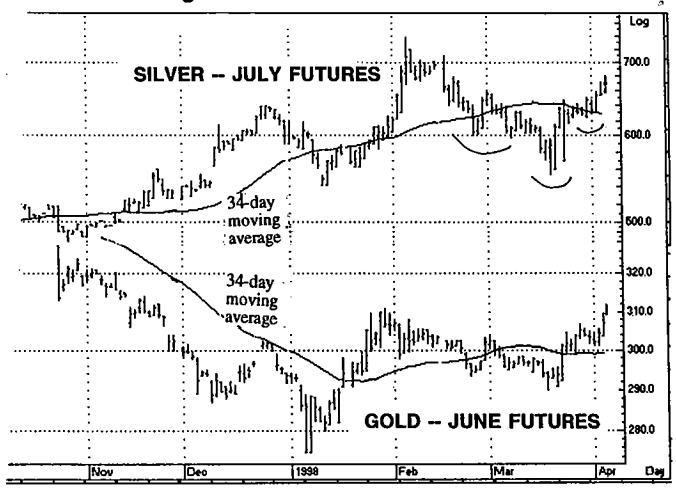
Now let's use what more analysts use, which is the yield on the 30-year bond, which is now 5.85%. On this basis, the market is on the high side of valuation, but if earnings on the Dow can reach say 500 for the coming 12 months, then we're talking about an earnings yield of about 5.55% against a bond yield of 5.85%. On that basis, the market is still a bit overvalued but not by very much.

Make no mistake about it, the above are the "valuations" which every analyst is now watching or using. The "cute" part of it is that the analysts can extrapolate earnings as far out as they want, using projected 1999 earnings (which some are already doing) or even earnings for the year 2000. It's a great system, and it will continue -- until the time when earnings cease to come through as predicted. And yes, it's a new world: dividends, book values, the old valuations, they've given way to the new math. And the new math may work very well -- until the next bear market.

PRECIOUS METALS: Soros has invested in Apex Silver Mines and Buffett has bought a carload of actual silver. What are they doing? What do they know? Buffett stated that his silver purchase had nothing to do with inflation -- he was buying silver strictly on a supply/demand basis. What demand? My theory -- silver is being used in the new high-energy silver-zinc battery. With electric cars coming in, silver may in months ahead become a hot commodity (one of the problems of the electric car has been the inadequacy of long-life batteries, and the silver-zinc battery may be one answer). At any rate, Soros and Buffett tend to know what they're doing. In the meantime, long-suffering precious metal buffs are wondering if this, finally, could be "the real deal."

Turning to the charts, silver and gold are now **both** above their 34-day moving averages. On Monday (March 6) gold (June futures) surged well above its January peak, thereby rising to a new high for the year. Thus, gold at this point is looking better than it has in a long time. And yes, gold shares have firmed considerably with many (including my favorite, Barrick) up more than 50% from their January 15 lows.

As for silver, here we see that July silver futures have traced out a head-and-shoulders bottom. Last week silver broke above resistance, and the metal should now be in line to try for its February 5 closing high of 7.08. You can be sure that Buffett and Soros are watching.



NEXT MAILING: April 22, 1998

LATE BOND NOTES: With short rates holding steady and official inflation rates almost negative, this process amounts to rising "real interest rates" in the US. The yield spread between US bonds and foreign bonds is the most favorable for US bonds in over a decade. Rendering US bonds even more attractive for foreign buyers is the very strong US dollar.

LATE NOTES: We've been seeing extremely heavy insider selling over recent weeks. There has been heavy insider selling, heavy buying by the mutual fund public, and this is a market that is selling literally on next year's earnings projections. It's wild, wilder than anything I've seen since 1968. Listening to CNBC I was interested when the crew cheered as Dow 9000 was bettered during the first hour of the session. It reminded me of the bell ringing in one of the Las Vegas casinos when someone hits a big jackpot, and everybody runs over to watch the coins tumble out of the slot machine.

After three years of over-20% increases, the market is up (this is the fourth year) 12% so far in '98. It's unprecedented action, but what do they say -- "records are meant to be broken?" This is the way I think about the market -- "at any given time, what is the most unexpected thing the market can do?" So far, what the stock market has done is rise further and longer than even the most avid bull could envision. And what's the sentiment now? It seems to me that the prevailing sentiment is that this market (along with earnings) will continue higher as far as the eye can see. (Or else, why would billions of dollars be coming into equity funds every week?) So what's the most unexpected thing the market could do now? Well, it could continue to rise, or . . .